



**United States Government Accountability Office  
Washington, DC 20548**

February 26, 2007

The Honorable Carl Levin  
Chairman  
The Honorable John McCain  
Ranking Minority Member  
Committee on Armed Services  
United States Senate

The Honorable Ike Skelton  
Chairman  
The Honorable Duncan L. Hunter  
Ranking Minority Member  
Committee on Armed Services  
House of Representatives

**Subject: *Defense Management: DLA Has Made Progress in Improving Prime Vendor Program, but Has Not Yet Completed All Corrective Actions***

The Department of Defense (DOD) operates a worldwide supply system, with the vast majority of the items being managed by the Defense Logistics Agency (DLA).<sup>1</sup> Media reports in October 2005 raised concerns about the use of the prime vendor concept and the prices that DLA was paying for items acquired through a prime vendor, and the House Armed Services Committee held a hearing on the matter on November 9, 2005.<sup>2</sup> As a result of the hearing, DLA officials recognized the need to improve management oversight and internal controls over the program, and they proposed a series of corrective actions.

Under the prime vendor concept, DOD relies on a distributor of a commercial product line, who provides that product line and incidental services to customers in an assigned region or area of responsibility. Products or services are to be delivered within a specified period of time after order placement. The prime vendor provides the product either at the cost paid to obtain it or at a price agreed upon in advance

---

<sup>1</sup>DLA is DOD's largest combat support agency, providing worldwide logistics support in both peacetime and wartime to the military services as well as several civilian agencies and foreign countries.

<sup>2</sup>The prime vendor program uses a contractual arrangement with one or more commercial vendors to supply a wide range of commercial off-the-shelf material directly to military customers on a just-in-time basis.

<b>Report Documentation Page</b>			<i>Form Approved OMB No. 0704-0188</i>	
<p>Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.</p>				
1. REPORT DATE <b>26 FEB 2007</b>	2. REPORT TYPE	3. DATES COVERED <b>00-00-2007 to 00-00-2007</b>		
4. TITLE AND SUBTITLE <b>Defense Management: DLA Has Made Progress in Improving Prime Vendor Program, but Has Not Yet Completed All Corrective Actions</b>				
5a. CONTRACT NUMBER				
5b. GRANT NUMBER				
5c. PROGRAM ELEMENT NUMBER				
6. AUTHOR(S)				
5d. PROJECT NUMBER				
5e. TASK NUMBER				
5f. WORK UNIT NUMBER				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>U.S. Government Accountability Office, 441 G Street NW, Washington, DC, 20548</b>				
8. PERFORMING ORGANIZATION REPORT NUMBER				
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				
10. SPONSOR/MONITOR'S ACRONYM(S)				
11. SPONSOR/MONITOR'S REPORT NUMBER(S)				
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>				
13. SUPPLEMENTARY NOTES				
14. ABSTRACT				
15. SUBJECT TERMS				
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>18</b>
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>	19a. NAME OF RESPONSIBLE PERSON	

with DLA plus a handling fee. In fiscal year 2006, prime vendor sales accounted for approximately \$7.25 billion, or 20 percent, of DLA's total sales and service of \$36 billion.

The use of prime vendor contracts is governed by the Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement. DLA manages the program and the Director of DLA reports to the Under Secretary of Defense for Acquisition, Technology, and Logistics through the Deputy Under Secretary of Defense for Logistics and Materiel Readiness. The Defense Supply Center Philadelphia (DSCP), a field activity of DLA, is the lead center for managing prime vendor contracts for three major supply chains: medical materiel, subsistence/garrison feeding, and construction and equipment. Medical materiel includes pharmaceutical and medical/surgical items. Subsistence includes food for troop feeding. The construction and equipment supply chain comprises several commodities, including maintenance, repair, and operations (MRO),<sup>3</sup> lumber, and metals. DSCP is also the lead center for the clothing and textiles supply chain, which does not include any prime vendor contracts.

In June 2006, we summarized the main findings of DLA internal reviews, and an external review conducted by the Defense Contract Management Agency at DLA's request, of DLA's prime vendor programs.<sup>4</sup> The findings highlighted five deficiencies, as follows:

- management metrics that were too narrowly focused on sales,
- a prime vendor concept that was not suitable for all commodities,
- a lack of management oversight,
- inadequate pricing reviews,<sup>5</sup> and
- a lack of knowledge or skills in the workforce.

We also reported that DLA had experienced persistent problems in overseeing prime vendor contracts, despite the existence of oversight policies and procedures and the identification of corrective actions prior to November 2005. Those problems persisted because DLA and DSCP management had not provided the oversight needed to ensure that the policies, procedures, and corrective actions were implemented. We therefore recommended that the Secretary of Defense ensure that the Director of the DLA provide continual management oversight of the corrective actions DLA was taking to address the problems in its prime vendor program.

---

<sup>3</sup>The MRO category is further broken out between supplies and services, with separate prime vendor contracts for each.

<sup>4</sup>GAO, *Defense Management: Attention Is Needed to Improve Oversight of DLA Prime Vendor Program*, GAO-06-739R (Washington, D.C.: June 19, 2006).

<sup>5</sup>The term "pricing review" was used in our June 2006 report to refer to a review for price reasonableness. For purposes of this report and in light of newly revised and clarified DLA policies, we use the term "price reasonableness determination" to refer to the contracting function of determining fair and reasonable pricing. We use the term "price review" to refer to the oversight function of auditing the contracting officer's price reasonableness determination.

A House Armed Services Committee report accompanying the fiscal year 2007 Defense Authorization bill directed GAO to review DLA's actions and submit a report to the defense committees no later than March 1, 2007. Our objective was to determine the extent to which DLA's corrective actions have addressed the main deficiencies in the prime vendor program. To accomplish this objective, we reviewed the actions DLA and DSCP have taken. We also reviewed a new DLA policy that governs the use of prime vendor contracts and DSCP's adherence to that policy and implementing procedures. In addition, we reviewed internal assessments of DLA's and DSCP's management of prime vendor contracts, as well as prior GAO reports. Further, we interviewed DLA and DSCP officials, as well as officials in the Office of the Deputy Under Secretary of Defense for Logistics and Materiel Readiness. We conducted our review between August 2006 and January 2007, in accordance with generally accepted government auditing standards. Our scope and methodology are discussed in further detail at the end of this report.

## **Results in Brief**

DLA has made progress in identifying and implementing a series of corrective actions to address the five main deficiencies we indicated earlier in the management of its prime vendor program, but it has not yet completed all the actions, and some deficiencies remain. Until DLA completes all the actions, we cannot fully assess whether they will be effective in correcting all the deficiencies and sustaining the improvements. DLA has effectively rectified two of the deficiencies by completing actions to broaden its management metrics and adjust its acquisition strategy for commodities that were not suitable for the prime vendor concept. However, it is still in the process of implementing corrective actions to remedy the three remaining deficiencies noted in our June 2006 report—those relating to management oversight, pricing reviews, and workforce knowledge and skills.<sup>6</sup> To address these three deficiencies, DLA has issued a new policy and DSCP has developed implementing procedures that prescribe oversight for prime vendor contractors; authorized additional positions to enhance oversight and developed training requirements for its staff; and introduced specific requirements for supply chains to conduct price reasonableness determinations and more price reviews. Nevertheless, these improvements are still a work in progress. For example, a new division at DSCP, established to ensure that supply chains are following procedures, is still in the process of hiring and training staff and has recently revised its procedures. Further, personnel responsible for one commodity within the construction and equipment supply chain had not conducted price reasonableness determinations as required by the new policy, resulting in a backlog of 11,260 items that needed review, representing an estimated value of \$96 million. As of January 2007, DSCP personnel had reduced the backlog to 480 items that needed additional research. Finally, some supply chains have not yet been able to meet their staffing requirements. The shortage of personnel in the supply chains has led to heavier workloads for current

---

<sup>6</sup>GAO-06-739R.

staff as well as to delays in completing contract actions. Until DLA completes all the corrective actions that are still in process, it remains at risk of being overcharged for the products it is purchasing. DLA faces further challenges in sustaining the improvements it has made because of impending leadership changes and by virtue of its history of not following through on correcting deficiencies. Our prior work has shown that one of the elements needed for sustaining management improvement initiatives is demonstrated leadership commitment.<sup>7</sup> While the current leadership at DLA and DSCP have demonstrated their commitment to implementing the corrective actions, personnel turnover can be expected in a large organization such as DLA—for example, the Commander of DSCP will reach the end of his 2-year term in mid-2007—and future leaders may not necessarily complete the corrective actions. DLA's history reflects the vulnerability of the prime vendor program to systemic pricing problems, because management has not always provided the oversight necessary to ensure that corrective actions were implemented. Because of these factors, and to mitigate its risk of being overcharged for its purchased products, DLA needs to ensure that the course of corrective actions is completed and the actions are working as intended and the improvements in oversight are sustained.

We are recommending that the Secretary of Defense require the Director of the Defense Logistics Agency to determine whether all the corrective actions in DLA's prime vendor program have been completed and are producing the intended results. The results of the determination should be communicated in writing to the Under Secretary of Defense, Acquisition, Technology, and Logistics within 6 months of the issuance of this report. In commenting on a draft of our report, DOD concurred with our recommendation. We discuss DOD's comments later in this correspondence.

## Background

Under the prime vendor concept, DOD relies on a distributor who provides a commercial product line (such as electrical and plumbing equipment) and incidental services to customers in an assigned region or area of responsibility. Products or services are to be delivered within a specified period of time after order placement. Since 1991, we have identified the use of prime vendors as a best commercial practice for inventory management.<sup>8</sup>

In 1992, we identified DOD's contract management as one of our high-risk areas, and it remains so today.<sup>9</sup> One of the key reasons why the area is high risk is that DOD

---

<sup>7</sup>GAO, *Management Reform: Elements of Successful Improvement Initiatives*, GAO/T-GGD-00-26 (Washington, D.C.: Oct. 15, 1999).

<sup>8</sup>GAO, *Defense Inventory: Opportunities Exist to Expand the Use of Defense Logistics Agency Best Practices*, GAO/NSIAD-00-30 (Washington, D.C.: Jan. 26, 2000). A best commercial inventory practice is defined in The National Defense Authorization Act for Fiscal Year 1998 as a practice that enables the agency to reduce inventory levels and holding costs while improving the responsiveness of the supply system to user needs.

<sup>9</sup>GAO, *Defense Contract Pricing*, GAO/HR-93-8 (Washington, D.C.: Dec. 1, 1992), and *High-Risk Series: An Update*, GAO-07-310 (Washington, D.C.: January 2007).

does not provide adequate oversight of defense contracts. One aspect of oversight is to ensure that the government is obtaining fair and reasonable contract prices.

Our prior work on federal management issues suggests that certain elements are particularly important in implementing and sustaining management improvement initiatives that genuinely take root and eventually resolve the problems they are intended to fix.<sup>10</sup> These elements include: demonstrated leadership commitment; integration of improvement initiatives into the day-to-day activities of the organization; thoughtful and rigorous planning to guide decisions, particularly to address human capital (and technology) issues; and organizational realignment to streamline operations and clarify accountability. According to the Standards for Internal Control in the Federal Government, effective management of an organization's workforce—its human capital—is essential to achieving results and is an important part of internal control.<sup>11</sup> Management should ensure that skill needs are continually assessed and that the organization is able to obtain a workforce that has the required skills necessary to achieve organizational goals. As a part of its human capital planning, management should also consider how best to retain valuable employees, plan for their eventual succession, and ensure continuity of needed skills and abilities.

### **Progress Has Been Made, but Some Deficiencies Remain in DLA's Prime Vendor Program Because All Actions Have Not Been Completed**

DLA has made progress in implementing the corrective actions to address the problems identified in our June 2006 report; however, it has not yet completed all the actions, and some program deficiencies remain. Until DLA completes all the actions, we cannot fully assess whether they will be effective in correcting all the deficiencies. DLA's actions have corrected two of the main deficiencies identified in our June 2006 report—management metrics that were too narrowly focused on sales, and a prime vendor concept that was not suitable for all commodities. DLA is now reviewing a broader range of prime vendor contracting metrics, and it has adjusted its acquisition strategy for commodities that were not suitable for the prime vendor concept. Deficiencies remain, however, in the areas of management oversight, the process of conducting price reasonableness determinations for one commodity, and the shortage of staff with required skills. DLA is continuing its work to address these three areas. However, DSCP's Compliance Division had not, at the time of our review, been able to complete all the oversight reviews called for by current DSCP procedures. Contracting personnel responsible for one commodity, MRO Supplies, had not completed price reasonableness determinations, as required by DLA policy, which led to a backlog of around 11,260 items that needed to be reviewed. The estimated value of these items was around \$96 million. Further, DSCP has had difficulty in finding qualified personnel to perform contracting and oversight

---

<sup>10</sup>GAO/T-GGD-00-26.

<sup>11</sup>GAO, *Standards for Internal Control in the Federal Government*, AIMD-00-21.3.1 (Washington, D.C.: November 1999).

functions. Finally, DSCP will experience changes in leadership, which could affect the implementation of the corrective actions.

#### DLA Has Remedied Deficiencies Regarding Metrics and the Use of the Prime Vendor Concept

DLA's management oversight has traditionally focused on performance metrics such as sales, fill rates, and customer satisfaction. Our June 2006 report<sup>12</sup> noted that one factor that could have influenced the lack of pricing reviews in some commodities was the emphasis that DLA management had traditionally placed on increasing sales to customers, rather than on the prices prime vendors charge for items. In response to this finding, DLA and DSCP management are now reviewing a much broader range of metrics to assess the prime vendor programs. DLA has established a headquarters-level quarterly acquisition integrity review process in order to provide more oversight for all its field activity centers. The quarterly acquisition integrity review assesses risk across all field activity centers (including DSCP), and it contains updates on specific DLA oversight programs, such as procurement management reviews, contract reviews, and integrated acquisition review boards. The quarterly assessment also includes data on field-specific oversight programs, such as price reviews and compliance reviews. In addition to metrics on sales data and fill rates, DSCP management, now on a monthly basis, reviews pricing and contracting metrics such as price reasonableness determinations, price changes, pricing history, and refund data. DLA has also developed automated tools to assist in gathering and tracking these metrics. Among other things, these tools track price change, price exception, and price history data that are reviewed by DSCP management.

The prime vendor concept has also been reevaluated by DLA. Prime vendor arrangements generally are chosen for the purchase of commercial off-the-shelf items, not military-unique items. While the purpose of the prime vendor concept has not changed, its application over time has expanded to include more commodities. DLA has recognized that certain commodities are better suited than others for the prime vendor concept, and it has adjusted its acquisition strategy accordingly. For example, DLA did not renew the prime vendor contracts for food service equipment when they expired in June 2006, and will use long-term contracts to acquire that commodity.<sup>13</sup> DSCP management has conducted analyses of its prime vendor programs and concluded that multiple award, long-term contracts, which compete orders among vendors, are more suitable for some commodities than for others.<sup>14</sup> As

---

<sup>12</sup>GAO-06-739R.

<sup>13</sup>According to DLA, a long-term contract is defined as an indefinite-delivery contract in excess of 1 year (including options).

<sup>14</sup>Similar to the prime vendor program, DSCP will award multiple award long-term contracts on a regional basis. DSCP will select several contractors within each region, and then compete orders among these contractors. According to DSCP officials, competing the orders will reduce the need to conduct price reasonableness determinations for each order, and the need to maintain price lists or catalogues, as in the prime vendor program.

a result, the number of prime vendor programs has decreased from 15 to 7. Table 1 lists the current acquisition strategies for the various commodities.

**Table 1: Acquisition Strategy for DLA Prime Vendor Programs**

<b>Commodities originally acquired through DLA prime vendor programs</b>	<b>Current acquisition strategy</b>
1. MRO Supplies <sup>a</sup>	Prime vendor program
2. MRO Services	Prime vendor program
3. Special Operations	Prime vendor program
4. Subsistence (Garrison Feeding)	Prime vendor program
5. Pharmaceutical	Prime vendor program
6. Medical/Surgical	Prime vendor program
7. Metals	Prime vendor program <sup>b</sup>
8. Food Service Equipment	Will be long-term indefinite-delivery contracts
9. Fire & Emergency Services	Long-term indefinite-delivery contracts
10. Lumber	Long-term indefinite-delivery contracts
11. Pallets	Long-term indefinite-delivery contracts
12. Ecclesiastical	Long-term indefinite-delivery contracts
13. Container Drums	Long-term indefinite-delivery contracts
14. Material Handling Equipment	Will be long-term indefinite-delivery contracts
15. Administrative Products	Blanket Purchase Agreement canceled

Source: GAO analysis of DLA and DSCP data.

<sup>a</sup>This commodity has separate contracts for Central Command supplies and non-Central Command supplies.

<sup>b</sup>Currently prime vendor, but acquisition strategy being developed.

In addition to adjusting the acquisition strategies for some prime vendor programs, in November 2006, DLA hired a contractor to conduct analyses to determine the cost savings, cost avoidance, and customer benefits from each of the prime vendor programs. The contractor is expected to complete the analyses by the end of March 2007.

#### Deficiencies Remain in Oversight, Price Reasonableness Determinations for One Commodity, and Staffing

DLA has taken actions to remedy deficiencies in the areas of management oversight, the process of conducting price reasonableness determinations for one commodity, and the shortage of staff with the required skills. Nevertheless, these improvements are still a work in progress.

## Management Oversight Guidance Has Not Been Fully Implemented

To improve its management oversight of the prime vendor program, DLA has issued a new policy that increased the level of oversight required for prime vendor contracts. DSCP, also, has updated its procedures to implement this new policy. However, a new division established at DSCP to ensure that supply chains are following procedures has not been able to conduct all the assessments required by the new policy and procedures.

Among the management oversight problems we identified in 2006 was pricing, and one of the actions DLA took to address it was the promulgation of a new policy in June 2006 to implement regulatory guidance for prime vendor contracts. The key points of the June policy included

- specific requirements for management oversight, such as pricing and compliance audits;
- requiring all prime vendor contracts to comply with an established prime vendor pricing model;
- annual local procurement management reviews for all prime vendor contracts; and
- requiring approval by headquarters for all prime vendor contracts, regardless of dollar value.

We found in our present review of the June 2006 policy that some of the examples of commodities used to illustrate various prime vendor arrangements were not associated with the correct pricing model. We discussed the apparent discrepancy with DLA officials, and subsequent to our discussions, DLA clarified the model and issued a revised policy in November 2006. The revised policy, among other things, also addressed management oversight, acquisition planning, and acquisition workforce training.<sup>15</sup>

DLA and DSCP management have taken a series of steps to improve oversight of prime vendor programs. These include setting up a Compliance Division within the Procurement Directorate at DSCP to ensure that prime vendor contracts are being executed and administered in accordance with applicable rules and regulations; increasing the number of price reviews conducted by supply chains; and requiring that all prime vendor contracts be approved by DLA headquarters. In addition, the DLA Director provides updates on prime vendor program issues, as needed, to the Deputy Under Secretary of Defense for Logistics and Materiel Readiness, as part of their regularly scheduled meetings to discuss DLA matters. Further, DLA is establishing a new Acquisition Management Directorate at the headquarters level to emphasize the importance of the entire acquisition workforce, and to enhance oversight. Another step that DSCP management took to improve oversight was to require all supply chains to use a standardized mechanism to track repeat findings

---

<sup>15</sup> According to a DLA official, there is no specific requirement for annual local procurement management reviews in the revised policy because that requirement already exists in field activity guidance; further, the reviews cover all procurement activities, not just those related to prime vendors.

from procurement management reviews. This mechanism allows management to determine the cause of a repeat finding.

Oversight guidance has not been fully implemented, however. According to the DSCP Guiding Principles for Acquisition, the Compliance Division's quarterly reviews will include several assessments related to price reasonableness determinations. As of early December 2006, however, we found that the two reviews it had completed did not include all the assessments called for in the DSCP guidance. Procurement Directorate officials attributed the shortfall to the division's heavy workload and the fact that it is not yet fully staffed. They further observed that even if the division were fully staffed, conducting all the assessments listed in the guidance would not be possible because they are so extensive. The officials noted that the procedures were determined in a relatively short time frame by another organization and were not reviewed for practicability. The Compliance Division has revised its standard operating procedures for the quarterly reviews to more realistically reflect its current capabilities. A December 2006 DLA internal review of the corrective actions in the prime vendor program, requested by DLA management, expressed concern that the new procedures may weaken oversight.<sup>16</sup> To address this concern, the Compliance Division now reviews a sample of contract documentation on a monthly basis to ensure that contracting officers are conducting price reasonableness determinations. We believe that until the Compliance Division is fully operational, management may lack all the information needed to provide proper oversight.

The two completed quarterly reviews examined contracting officers' documentation for determining prices to be fair and reasonable, vendors' compliance with pricing methodology, and contract terms specifying fill rates. These reviews found that contracting personnel and vendors for most commodities provided adequate price reasonableness documentation and complied with pricing methodology and contract terms. However, in a few cases, either contracting personnel or the vendor did not provide the price reasonableness documentation. The Compliance Division subsequently met with contracting personnel in the various commodities to clarify what documentation is needed to verify their price reasonableness determinations.

#### Price Reasonableness Determinations for One Commodity Were Not Done as Required

To improve its pricing procedures for various commodities, DLA's 2006 policy established pricing models to be used for different types of prime vendor contracts. The pricing models generally require price reasonableness determinations to be made for all items priced at \$2,500 or greater. However, for one prime vendor program—MRO Supplies commodity within the construction and equipment supply chain—price reasonable determinations are to be done for at least 30 percent of items priced from \$2,500 to \$24,999 before the prime vendor can process the order. The price

---

<sup>16</sup>Defense Logistics Agency, *Audit Report on Corrective Actions Taken as a Result of Identified Deficiencies in the Prime Vendor Program* (Fort Belvoir, Va.: Dec. 21, 2006).

reasonableness determinations for the remaining 70 percent of such items are to be done no later than 60 days after an order is issued. DSCP officials implemented this procedure in February 2006—that is, prior to the June 2006 issuance of DLA's policy. However, in September 2006, we found that none of the 70 percent of items priced from \$2,500 to \$24,999 had been reviewed. As a result, DSCP had accrued a backlog of price reasonableness determinations to conduct, extending to 11,260 lines, with an approximate value of \$96 million.

Management at DLA and DSCP had not developed a plan to address this backlog until we identified the issue. According to DSCP officials, several factors played into the development of the backlog. First, DSCP could not easily identify the 70 percent of the items that needed a price reasonableness determination. This problem has since been addressed with the advent of a new automated management information system. Second, according to DSCP officials, they did not have enough personnel to address the backlog. DSCP officials told us that they are actively working to address this issue. Finally, they said, the volume of business also played a role in the growth of the backlog.

After we called their attention to this issue, DSCP officials developed a plan to conduct the determinations and to prevent this magnitude of backlog from developing again. DSCP officials reported as of late January 2007 that they had completed an initial review of all 11,260 lines and price reasonable determinations had been made on 10,780 of these lines. However, 480 lines required additional research to make the price reasonableness determination. According to a DSCP official, there is a possibility that some refunds may be required. We believe that until DSCP completes the price reasonableness determinations for all the items, there remains a risk that it was overcharged for some items.

DLA and DSCP officials acknowledged that there was a risk but said that they had taken action to mitigate it by modifying the prime vendor contracts to include a purchasing review clause. This clause allows DLA access to the contractor's records and information pertaining to those items or services for which the government is relying on the contractor's purchasing system to determine that competition was obtained, or to justify that prices are fair and reasonable. In addition, if a purchased product or service is determined to be unreasonably priced, the contractor shall refund the government the amount that is in excess of a reasonable price. DLA and DSCP officials told us that incorporating the purchasing review clause mitigated the risk of being overcharged. According to a DLA official, DSCP has completed audits of four prime vendors to ensure compliance with the clause, but the reports had not been finalized as of the end of January 2007. Because the clause is relatively new, it remains to be seen how effective it will be.

#### Some Supply Chains Have Not Been Able to Meet Their Staffing Requirements

To improve the capability of its workforce, DLA has authorized additional staffing at DSCP to perform price reasonableness determinations, audits, and other oversight. DLA has also hired additional personnel at headquarters to monitor findings from

procurement management reviews. One aspect of oversight is ensuring the presence of a workforce that has the skills and knowledge needed to oversee contracts. However, DSCP officials told us that they have been unable to fill all of the newly authorized positions because of difficulties in finding and hiring qualified personnel. These positions require highly specialized contracting skills, which are difficult to find. When a qualified acquisition person is found, the new staff member must be trained in the nuances of the particular commodity, as well as in the management of a prime vendor arrangement, in order to be fully effective. The shortage of personnel in the supply chains has led to heavier workloads for current staff as well as to backlogs of contract actions.

Similarly, the Compliance Division does not yet have the skilled workforce that it needs to perform its oversight function. The division was authorized to have a staffing level of 17, yet as of December 2006, only 15 slots have been filled. The director of the division told us that the division was initially staffed by whoever was available. None of those staff had training in conducting compliance reviews. Currently, only about half of the personnel in this new division have the training or skills needed to perform their tasks. DSCP is aware of the inexperience of many Compliance Division personnel, and has recently developed a training plan for them.

For their part, DLA and DSCP are exploring different methods of recruiting qualified acquisition personnel. For example, DSCP established a standing-register job opportunity announcement for acquisition personnel, initially open to federal employees in the Philadelphia area and subsequently broadened to include all federal activities nationwide. Further, DSCP issued a recruitment bulletin targeted toward separated, retired, or soon-to-retire military personnel, and it has also used an Office of Personnel Management announcement designed to recruit from the private sector. In addition to recruiting qualified acquisition personnel, DLA and DSCP have established a semiannual recruitment cycle to hire entry-level acquisition personnel. Until DLA and DSCP are able to fill all the positions, contract oversight may be inadequate.

### **DLA May Face Challenges in Sustaining Improvements**

Our previous work has shown that demonstrated leadership commitment is an element of particular importance in implementing and sustaining management improvement initiatives.<sup>17</sup> The current leadership at DLA and DSCP have demonstrated their commitment to correcting the oversight problems. For example, the DLA senior acquisition executive has briefed supply center staff on the importance of oversight, and the DSCP Commander has made personnel changes to enhance oversight. DLA management has also authorized more positions at DSCP and at headquarters to strengthen contracting and oversight staff. Further, DSCP management has requested approval for a new acquisition executive position to oversee all procurement activity for the center, and it has already received DLA approval for a Deputy Director position for the Procurement Directorate. However,

---

<sup>17</sup>GAO/T-GGD-00-26.

as with most federal agencies, the leadership is continually changing. The current Director of DLA took over that position in August 2006. The DSCP Commander will complete his 2-year term as Commander in mid-2007. A new Deputy Commander will replace the current one, who is serving in a temporary capacity, in early 2007. Further, DSCP is continuing to hire acquisition personnel. In light of the personnel changes occurring at both the management and operational level, the significant changes in program operating procedures, and the establishment of new oversight mechanisms, DLA may face challenges in sustaining the improvements it is implementing in the prime vendor program. DLA's history reflects the vulnerability of the prime vendor program to systemic pricing problems. Despite guidance and reforms to which the agency has committed over time, these issues have beset DLA for a long time, because management has not always provided the oversight necessary to ensure that corrective actions were implemented.

## **Conclusions**

DLA's recent progress in implementing actions to improve oversight of the prime vendor program to date has been promising. However, systemic pricing problems remain an area of risk for this program. Critical to DLA's ability to realize substantial improvements in the oversight of the prime vendor program will be rectifying the program's long-standing problems described in this report. DLA's ability to address these remaining problems is dependent on completing procedural improvements and filling contract oversight positions with qualified staff. Whether this will occur as intended is not a certainty. DLA's history of problems in overseeing prime vendor contracts, the expected turnover in leadership and operating personnel, and the significant changes made to program operating procedures could pose significant risks to sustaining the improvements made to program oversight. It is important that DLA and DSCP management fully implement all the corrective actions and sustain the improvements over the long term so the intended results are achieved.

## **Recommendation**

We recommend that the Secretary of Defense direct the Under Secretary of Defense, Acquisition, Technology, and Logistics to require the Director of DLA to determine whether all the corrective actions in DLA's prime vendor program have been completed and are producing the intended results. This determination should identify any remaining or additional actions necessary to remedy the deficiencies in the prime vendor program. This determination should also specify a time frame for the completion of these actions. The results of the determination should be communicated in writing to the Under Secretary of Defense, Acquisition, Technology, and Logistics within 6 months of the issuance of this report.

## **Agency Comments**

In written comments on a draft of this report, the Deputy Under Secretary of Defense for Logistics and Materiel Readiness, which is responsible for DLA oversight, concurred with our recommendation and noted that DLA has made progress in

implementing the corrective actions, and is committed to ensuring that the remaining actions are completed and are producing the intended results. The written comments from the Deputy Under Secretary of Defense for Logistics and Materiel Readiness are included in the enclosure following this report.

### **Scope and Methodology**

To determine the extent to which DLA's corrective actions have addressed the major deficiencies in the prime vendor program, we discussed the status of actions taken and results of these actions with DLA and DSCP officials. Specifically, we discussed the changes to management oversight, new procedures for price reviews, metrics used to assess the prime vendor programs, acquisition strategies for commodities originally classified as prime vendor programs, and efforts to train and recruit personnel. In addition, we discussed with representatives from the Office of the Deputy Under Secretary of Defense for Logistics and Materiel Readiness their role in overseeing the implementation of DLA's corrective actions and reviewed prime vendor program briefings provided these officials by DLA. We also reviewed and analyzed a new DLA policy governing the use of prime vendor contracts, DSCP procedures for implementing the policy, DSCP's adherence to the policy and procedures, internal assessments of DLA's and DSCP's management of prime vendor contracts, and prior GAO reports. Further, we reviewed a judgmental sample of documentation supporting contracting officers' price reasonableness determinations for two commodities within the construction and equipment supply chain. Finally, we interviewed officials from the Deputy Under Secretary of Defense for Acquisition and Technology, Defense Procurement and Acquisition Policy organization to discuss their role in assisting DLA with acquisition workforce planning. We conducted our review from August 2006 through January 2007 in accordance with generally accepted government auditing standards.

We are sending copies of this report to appropriate congressional committees; the Secretary of Defense; the Under Secretary of Defense, Acquisition, Technology and Logistics; the Deputy Under Secretary of Defense for Logistics and Materiel Readiness; and the Director, Defense Logistics Agency. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-5274 or [needhamjk1@gao.gov](mailto:needhamjk1@gao.gov) if you or your staff have any questions concerning this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Marilyn Wasleski, Assistant Director; Vijay J. Barnabas; John Clary; Janay Sam; Karen Thornton; and Cheryl Weissman.

A handwritten signature in black ink, appearing to read "John K. Needham". The signature is fluid and cursive, with a horizontal line extending to the right beneath the signature.

John K. Needham, Acting Director  
Defense Capabilities and Management

Enclosure

Enclosure: Comments from the Department of Defense



DEPUTY UNDER SECRETARY OF DEFENSE FOR  
LOGISTICS AND MATERIEL READINESS  
3500 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3500

February 14, 2007

Mr. John K. Needham  
Acting Director, Defense Capabilities and Management  
U.S. Government Accountability Office  
Washington, DC 20548

Dear Mr. Needham:

This is the Department of Defense (DoD) response to the GAO draft report GAO-07-396R, "DEFENSE MANAGEMENT: DLA Has Made Progress In Improving Prime Vendor Program, but Has Not Yet Completed All Corrective Actions," dated January 31, 2007 (GAO Code 350893). The GAO draft report recommends that the Director, Defense Logistics Agency determine whether all the corrective actions to the Prime Vendor Program have been completed and are producing the intended results and that the results of his determination be communicated in writing to the USD(AT&L) within 6 months from the date of the GAO report. The DoD concurs with the recommendation.

Comments on the draft report recommendation are included in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

A handwritten signature in black ink that reads "Jack Bell". Below the signature, the name "Jack Bell" is printed in a smaller, sans-serif font.

Enclosure:  
As stated



**GAO DRAFT REPORT – DATED January 31, 2007**  
**GAO CODE 350893/GAO-07-396R**

**"DEFENSE MANAGEMENT: DLA Has Made Progress In Improving Prime Vendor Program, but Has Not Yet Completed All Corrective Actions"**

**DEPARTMENT OF DEFENSE COMMENTS  
TO THE RECOMMENDATIONS**

**RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to require the Director of the Defense Logistics Agency to determine whether all the corrective actions in DLA's prime vendor program have been completed and are producing the intended results. This determination should identify any remaining or additional actions necessary to remedy the deficiencies in the prime vendor program. This determination should also specify a timeframe for the completion of these actions. The results of the determination should be communicated in writing to the Under Secretary of Defense (Acquisition, Technology and Logistics) within six months of the issuance of this report. (Pages 16-17/GAO Draft Report)

**DOD RESPONSE:** Concur. Defense Logistics Agency (DLA) has made substantial progress to implement the corrective actions taken within the prime vendor program and is committed to ensure all remaining actions have been completed and are producing the intended results. DLA continues to assess the implementation of the corrective actions through management oversight processes, program reviews, and updates. Within the six months specified, DLA will report in writing to the Under Secretary of Defense, Acquisition Technology and Logistics, as to whether all actions have been completed and are producing the intended results and will identify any remaining or additional actions required and specify a timeframe for the completion of the actions.

(350893)

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

### Order by Mail or Phone

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "Subscribe to Updates."

---

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Gloria Jarmon, Managing Director, [JarmonG@gao.gov](mailto:JarmonG@gao.gov) (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, D.C. 20548

---

## Public Affairs

Paul Anderson, Managing Director, [AndersonP1@gao.gov](mailto:AndersonP1@gao.gov) (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, D.C. 20548

---